STATE OF RHODE ISLAND
DEPARTMENT OF ATTORNEY GENERAL

October 28, 2013

DECISION

In Re: Initial Application of Prime Healthcare Services-Landmark, LLC, Prime Healthcare Services, Inc., Prime Healthcare Holdings, Inc., Prime Healthcare Management, Inc. and Jonathan N. Savage, Esq., in his capacity as the court-appointed Special Master for Landmark Health Systems, Inc., Landmark Medical Center and Northern Rhode Island Rehab Management Associates, L.P. d/b/a Rehabilitation Hospital of Rhode Island

The Department of Attorney General has considered the above-referenced application pursuant to R.I. Gen. Laws §§ 23-17.14-1, *et seq.*, the Hospital Conversions Act. In accordance with the reasons outlined herein, the application is **APPROVED WITH CONDITIONS.**

I. BACKGROUND

The first step in traversing the Hospital Conversions Act is the filing of an initial application with the Department of Attorney General and Department of Health ("DOH"). The parties filed their initial application ("Initial Application") on January 2, 2013. The parties (collectively, "Transacting Parties") to the Initial Application are identified below:

- **Landmark Medical Center** is a Rhode Island non-profit corporation that operates a 214 licensed bed acute care hospital located in Woonsocket, Rhode Island.
- **Northern Rhode Island Rehab Management Associates, L.P., doing business as Rehabilitation Hospital of Rhode Island** (the "Rehabilitation Hospital of Rhode Island") is a Delaware limited partnership operating a rehabilitation hospital located in North Smithfield, Rhode Island.
- **Landmark Health Systems, Inc.** is a Rhode Island non-profit corporation and the parent of Landmark Medical Center and the Rehabilitation Hospital of Rhode Island.
- **Prime Healthcare Services, Inc.** ("PHSI") is a Delaware corporation formed on March 27, 2000[1], that operates eighteen (18) acute care hospitals throughout California, Kansas, Nevada, Texas and Pennsylvania.[2]

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[1] PHSI was originally formed as K Reddy Corp., on March 27, 2000 and has had several name changes. Its final name change to Prime Healthcare Services, Inc. was on August 24, 2005. *See* Response to Initial Application Question 1 and Exhibit 10(bb).

- **Prime Healthcare Services –Landmark, LLC** ("Prime-Landmark") is a Delaware limited liability company formed on September 19, 2012 and is a wholly-owned subsidiary of PHSI.
- **Prime Healthcare Holdings, Inc.** is a Delaware corporation formed on April 21, 2010 and is the sole shareholder of PHSI.
- **Prime Healthcare Management, Inc.** ("Prime Management") is a Delaware corporation formed on February 24, 2002. It provides management, consulting and support services to hospitals owned and operated by PHSI.

See Response to Initial Application Question 1 and Exhibits 10 (a) – (gg)[3].

In its simplest form, the structure of the transaction outlined in the Initial Application (the "Proposed Transaction") is a sale of the assets of Landmark Medical Center and the Rehabilitation Hospital of Rhode Island to Prime-Landmark.

II. REVIEW CRITERIA

The review criteria utilized by the Department of Attorney General for a hospital conversion involving a conversion of a non-profit hospital to a for-profit hospital[4] is as follows:

> (1) Whether the proposed conversion will harm the public's interest in trust property given, devised, or bequeathed to the existing hospital for charitable, educational or religious purposes located or administered in this state;
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> (2) Whether a trustee or trustees of any charitable trust located or administered in this state will be deemed to have exercised reasonable care, diligence, and prudence in performing as a fiduciary in connection with the proposed conversion;
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> (3) Whether the board established appropriate criteria in deciding to pursue a conversion in relation to carrying out its mission and purposes;
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> (4) Whether the board formulated and issued appropriate requests for proposals in pursuing a conversion;

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[2] PHSI is also affiliated with Prime Healthcare Services Foundation, Inc., which is a 501(c)(3) public charity that owns and operates five (5) acute care hospitals in California. *See* Response to Initial Application Question 1.

[3] For the purposes of this Decision PHSI, Prime-Landmark, Prime Healthcare Holdings, Inc and Prime Management will be called collectively "Prime" and Landmark Medical Center, Landmark Health System and the Rehabilitation Hospital of Rhode Island will be called collectively "Landmark".

[4] R.I. Gen. Laws § 23-17.14-7(c).

(5) Whether the board considered the proposed conversion as the only alternative or as the best alternative in carrying out its mission and purposes;

(6) Whether any conflict of interest exists concerning the proposed conversion relative to members of the board, officers, directors, senior management, experts or consultants engaged in connection with the proposed conversion including, but not limited to, attorneys, accountants, investment bankers, actuaries, health care experts, or industry analysts;

(7) Whether individuals described in subdivision (c)(6) were provided with contracts or consulting agreements or arrangements which included pecuniary rewards based in whole, or in part on the contingency of the completion of the conversion;

(8) Whether the board exercised due care in engaging consultants with the appropriate level of independence, education, and experience in similar conversions;

(9) Whether the board exercised due care in accepting assumptions and conclusions provided by consultants engaged to assist in the proposed conversion;

(10) Whether the board exercised due care in assigning a value to the existing hospital and its charitable assets in proceeding to negotiate the proposed conversion;

(11) Whether the board exposed an inappropriate amount of assets by accepting in exchange for the proposed conversion future or contingent value based upon success of the new hospital;

(12) Whether officers, directors, board members or senior management will receive future contracts in existing, new, or affiliated hospital or foundations;

(13) Whether any members of the board will retain any authority in the new hospital;

(14) Whether the board accepted fair consideration and value for any management contracts made part of the proposed conversion;

(15) Whether individual officers, directors, board members or senior management engaged legal counsel to consider their individual rights or duties in acting in their capacity as a fiduciary in connection with the proposed conversion;

(16) Whether the proposed conversion results in an abandonment of the original purposes of the existing hospital or whether a resulting entity will depart from the traditional purposes and mission of the existing hospital such that a cy pres proceeding would be necessary;

(17) Whether the proposed conversion contemplates the appropriate and reasonable fair market value;

(18) Whether the proposed conversion was based upon appropriate valuation methods including, but not limited to, market approach, third party report or fairness opinion;

(19) Whether the conversion is proper under the Rhode Island Nonprofit Corporation Act;

(20) Whether the conversion is proper under applicable state tax code provisions;

(21) Whether the proposed conversion jeopardizes the tax status of the existing hospital;

(22) Whether the individuals who represented the existing hospital in negotiations avoided conflicts of interest;

(23) Whether officers, board members, directors, or senior management deliberately acted or failed to act in a manner that impacted negatively on the value or purchase price;

(24) Whether the formula used in determining the value of the existing hospital was appropriate and reasonable which may include, but not be limited to factors such as: the multiple factor applied to the "EBITDA" – earnings before interest, taxes, depreciation, and amortization; the time period of the evaluation; price/earnings multiples; the projected efficiency differences between the existing hospital and the new hospital; and the historic value of any tax exemptions granted to the existing hospital;

(25) Whether the proposed conversion appropriately provides for the disposition of proceeds of the conversion that may include, but not be limited to:

(i) Whether an existing entity or a new entity will receive the proceeds;

(ii) Whether appropriate tax status implications of the entity receiving the proceeds have been considered;

(iii) Whether the mission statement and program agenda will be or should be closely related with the purposes of the mission of the existing hospital;

(iv) Whether any conflicts of interest arise in the proposed handling of the conversion's proceeds;

(v) Whether the bylaws and articles of incorporation have been prepared for the new entity;

(vi) Whether the board of any new or continuing entity will be independent from the new hospital;

(vii) Whether the method for selecting board members, staff, and consultants is appropriate;

(viii) Whether the board will comprise an appropriate number of individuals with experience in pertinent areas such as foundations, health care, business, labor, community programs, financial management, legal, accounting, grant making and public members representing diverse ethnic populations of the affected community;

(ix) Whether the size of the board and proposed length of board terms are sufficient;

(26) Whether the transacting parties are in compliance with the Charitable Trust Act, chapter 9 of title 18;

(27) Whether a right of first refusal to repurchase the assets has been retained;

(28) Whether the character, commitment, competence and standing in the community, or any other communities served by the transacting parties are satisfactory;

(29) Whether a control premium is an appropriate component of the proposed conversion; and

(30) Whether the value of assets factored in the conversion is based on past performance or future potential performance.

In addition to reviewing the Initial Application submitted by the Transacting Parties and other publically available information, the Attorney General and DOH jointly interviewed the following individuals:

Landmark

1. Jonathan Savage, Esq., Special Master
2. Richard Charest, President of Landmark Medical Center and President/CEO of the Rehabilitation Hospital of Rhode Island
3. Glenn Fort, M.D., Chief Medical Officer, Landmark Medical Center
4. Robert Crausman, M.D., Former Chief Medical Officer, Landmark Medical Center
5. Tom Klessens, CFO, Landmark Medical Center

Prime[5]

6. Prem Reddy, M.D., President and CEO of PHSI, and President and CEO of Prime Management
7. Luis Leon, President of Operations II (hospitals outside California)
8. Michael Bogart, Vice President of Finance
9. Harsha Upadhyay, Vice President of Operations

Other

10. Charles Jones, President and CEO of Thundermist Health Center in Woonsocket, Rhode Island

[5]The individuals listed as management for PHSI are actually employed by Prime Management and provide services pursuant to a management agreement.

11. Christopher Callaci, General Counsel, United Nurses and Allied Professionals

The Hospital Conversions Act requires a public informational meeting. *See* R.I. Gen. Laws § 23-17.14-7(b)(3)(iv). A public notice was published regarding an informational meeting as well as soliciting written comments regarding the Proposed Transaction. The Attorney General and DOH jointly held this meeting in Woonsocket at the Woonsocket High School.[6] It was held on September 30, 2013 from 4 p.m. to 7 p.m.[7] At the beginning of the session, the Transacting Parties were provided an opportunity to give a presentation regarding the Proposed Transaction; afterwards, public comment was taken. Over the course of the meeting, over fifty (50) speakers provided public comment. The comments were overwhelmingly in favor of the Proposed Transaction, with none in opposition. Several written comments were also received, the overwhelming majority of which supported the Proposed Transaction.

The Initial Application, along with the supplemental information provided, information gathered from the investigation, including publically available information and information resulting from interviews and public comment, were all considered in rendering this Decision.

III. PROCEDURAL HISTORY

It is general knowledge that this is the second Hospital Conversion review involving Landmark conducted by the Attorney General and DOH in the recent past. Landmark Medical Center and the Rehabilitation Hospital of Rhode Island's search for a strategic partner began around 2008 as the financial situation at the hospitals worsened. Because a strategic partner was not located in a timeframe that could guarantee the continued operation and viability of

[6] The Attorney General would like to thank the staff of Woonsocket High School for their hospitality and for assisting us with use of the school.

[7] In order to include all individuals who signed up to speak, the Attorney General and DOH continued the meeting until almost 7:30 p.m.

Landmark, it was placed into Special Mastership.[8] The Court appointed attorney Jonathan Savage (the "Special Master") to act as special master for the three entities.

Given that there is now over five (5) years of history regarding Landmark, this section will focus on the events directly leading to the Proposed Transaction and not all events already covered in the previous decision regarding Landmark and Steward Healthcare System ("Steward").[9] Therefore, this procedural history section will begin with the ill-fated pursuit of Landmark by Steward and its predecessor Caritas Christi.

From early in the Special Mastership of Landmark and for several years, the Special Master's focus for a strategic partner for Landmark had been on Steward and its predecessor, Caritas Christi. On August 27, 2010, as a result of negotiations, an Asset Purchase Agreement was signed with CCHC Healthcare, Inc., a Rhode Island affiliate of Caritas Christi, a Catholic-affiliated organization operating six (6) community hospitals in Massachusetts.[10] For reasons that are not fully disclosed, Caritas Christi walked away from the Landmark deal in late 2010. During this same timeframe, the assets of Caritas Christi were purchased by Steward effective November 2010. As a result, the Caritas Christi hospitals became the first hospital assets of Steward.

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[8] *See* Gaube v. Landmark Medical Center P.M. No.: 08-4371 ("Landmark Special Mastership"), Gaube v. Landmark Health Systems C.A. No.: 08-5893 ("LHS Special Mastership") and Charest v. Northern Rhode Island Rehab Management Associates, Limited Partnership PB No.: 08-7186 ("RHRI Special Mastership" and collectively, "the Special Mastership").

[9] *See* Attorney General's Decision regarding the affiliation of Steward Health Care System, LLC, Steward Medical Holdings, LLC, Blackstone Medical Center, Inc. and Blackstone Rehabilitation Hospital, Inc. and Jonathan N. Savage, Esq., in his capacity as the court-appointed Special Master for Landmark Health Systems, Inc., Landmark Medical Center and Northern Rhode Island Rehab Management Associates, L.P. d/b/a Rehabilitation Hospital of Rhode Island, dated, May 25, 2012. (the "Landmark/Steward Decision").

[10] This Asset Purchase Agreement was signed only by CCHC Healthcare, Inc. and was not placed before the Court for approval.

After the split with Caritas Christi, the Special Master began to seek other bidders for Landmark. This was done using a formal bidding process through the Court. Several bidders presented themselves as interested in purchasing Landmark's assets.[11] On April 14 and 15, 2011, detailed bid hearings were held to review the bids. Prime was one of the bidders who participated in the bid hearings. After the hearings, a winning bidder was not automatically awarded. Instead, the Court gave the bidders additional time to "satisfy any and all of their respective contingencies to closing other than court and regulatory approval." *See* Landmark Special Mastership Order at para. 1, (dated, April 29, 2011). The contingency at issue regarding Prime was: "[g]ood faith negotiation of a mutually acceptable agreement with Blue Cross."[12] *See Id.* at para. 2(c). In a letter dated, May 6, 2011, Prime indicated to the Court that an agreement had been reached with Blue Cross.

The Court held an additional hearing on May 10, 2011 to choose a bidder. At that hearing, it was evident that all bidders had outstanding issues that the Court would like resolved before rendering a decision choosing a bidder. The issue regarding Prime was a recent news story that included allegations questioning the rates of particular diseases that certain Prime hospitals were reporting and the appropriateness of Prime's coding of such diseases. On May 12, 2011, Prime sent a seven (7) page letter with thirteen (13) pages of attachments to the Court outlining its position regarding these allegations. Shortly thereafter, on May 16, 2011, Prime sent a letter to the Special Master withdrawing its bid for Landmark. Its reasoning was "Blue Cross' unwillingness to negotiate a fair and reasonable contract...". Prime also expressed concern "about a process where [the Special Master is] permitted to communicate with new

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[11] One bidder, HealthSouth was only interested in purchase of the assets of the Rehabilitation Hospital of Rhode Island.

[12] "Blue Cross" refers throughout to Blue Cross Blue Shield of Rhode Island.

bidders at this late stage."[13] Surprisingly, after the bid hearings, but before decision, one by one, each bidder, including Prime, withdrew its bid leaving no bidder for Landmark.

With all bidders gone, Steward re-appeared on the scene. Days after all bidders left, on May 31, 2011, the Court approved an Asset Purchase Agreement with Steward presented by the Special Master. Steward subsequently filed a hospital conversion initial application in October 2011. Thereafter, a full hospital conversion review was performed, consisting of reviewing voluminous documentation, conducting numerous interviews, issuance and response to over eighty (80) follow-up questions and holding two public informational meetings. In all, this process from beginning to end took almost a year, four months of which was waiting for Steward to file the initial application after being chosen.

After this comprehensive review, the Attorney General approved the hospital conversion application involving Steward on May 25, 2012. The parties were given sixty (60) days to close the transaction. During this time, Steward attempted to negotiate a provider agreement with Blue Cross. Several parties attempted to facilitate these negotiations, including Judge Silverstein, the presiding justice in the Special Mastership, who appointed a mediator to assist and the Attorney General, who personally tried to facilitate negotiations. Ultimately, an agreement was not reached between Steward and Blue Cross. Thereafter, Steward formally walked away from the transaction upon sending a September 27, 2012 letter to the Special Master. It should be pointed out that while the existence of an agreement with Blue Cross was a specific condition precendent of the previous deal with Caritas Christi, it was not included as a condition in the Steward Asset Purchase Agreement. While Steward's letter stated that the reason for the withdrawal was that closing had not taken place within the timeframe stated in the Steward Asset Purchase

[13] As outlined herein, this statement is seemingly a reference to Steward.

Agreement,[14] it is clear that the failure of an agreement with Blue Cross was the real issue. Indeed, Steward has sued Blue Cross in the United States District Court for the District of Rhode Island specifically stating that: "[b]y engaging in the anti-competitive conduct described [in this Complaint], including its refusal to negotiate in good faith for reasonable reimbursement rates for Landmark, its needless and intentional disruption of Landmark's patient and payment flows, further damaging the hospital's already troubled finances, and its active role in discouraging other health care providers from dealing with Steward, [Blue Cross] purposely thwarted Steward's acquisition and planned revitalization of Landmark and thereby excluded [Steward] from Rhode Island..." *See* Complaint filed by Steward Health Care System, LLC, et. al. Case No. 13-405-S. This case is currently pending before the United States District Court for the District of Rhode Island.

The Attorney General notes that conducting a hospital conversion review requires the commitment of a substantial amount of resources at the Department of Attorney General.[15] A hospital conversion review also takes staff and resources away from other projects that could benefit the people of the State of Rhode Island. Suffice to say that a large amount of resources were expended on the review of Steward's proposed purchase.

Needless to say, the failure of Steward to go through with the purchase of Landmark and Rehabilitation Hospital of Rhode Island was deeply disappointing to all involved, especially to

[14] The date included in the Steward Asset Purchase Agreement was July 20, 2012. This expectation of a closing on such date was clearly not contemplated as several continuances for the closing date required in the Landmark/Steward Decision were requested and Steward continued to move towards a closing well after July 20, 2012.

[15] In addition, resources of the Department of Health were also taxed, where there was not only the hospital conversion review, but a separate review for Change in Effective Control, which resulted in a number of meetings of the Health Services Project Review Committee that were performed on an expedited basis.

the loyal staff of Landmark Medical Center and the Rehabilitation Hospital of Rhode Island and the patients they serve.

Faced again with a situation where there was no bidder for Landmark, the Special Master began to reach out to potential bidders. *See* Response to Initial Application Question 1. Entities that the Special Master spoke to included Care New England, Lifespan, CharterCare and Prime. *Id.* As a result of these discussions, on October 9, 2012, the Special Master's presented an Asset Purchase Agreement with Prime to the Court for approval. It has been indicated that the Prime Asset Purchase Agreement was based upon the Steward Asset Purchase Agreement. *See* Response to Initial Application Question 55.

In response to this turn of events, the Attorney General responded and brought several concerns regarding Prime and the Prime Asset Purchase Agreement to the Court's attention. Among those concerns, the Attorney General requested: (1) the Special Master's due diligence on Prime; (2) that in the event there may be others that are interested in purchasing Landmark, a transparent bid process shall be created; and (3) that the Court should require a guarantee by the parent corporation for Prime-Landmark's obligations under the Prime Asset Purchase Agreement. *See* Landmark Special Mastership, Attorney General's Response to Special Master's Petition for Instructions Regarding Asset Purchase Agreement Presented to the Special Master by Prime Healthcare Services-Landmark, LLC, (dated, October 5, 2012). However, at the hearing on October 31, 2012, the Court approved the Prime Asset Purchase Agreement with no further proceedings.[16]

The Transacting Parties filed the Initial Application approximately two months later, on January 2, 2013. On February 1, 2013, the Departments informed the Transacting Parties that

[16] Both Care New England and Lifespan had representatives that appeared at the October 31, 2013 hearing.

the Initial Application was incomplete and requested significant additional information. On March 14, 2013 the Transacting Parties re-filed their Initial Application. On March 29, 2013, the Departments again informed the Transacting Parties that the Initial Application was incomplete. At such time, the hospital conversion review was suspended. The only other alternative to suspension was rejection of the Initial Application, which would have resulted in the Transacting Parties having to re-file the entire application. Instead, the suspension allowed the Transacting Parties to work from the point where they were already and keep moving forward toward completeness.[17] Further, suspension causes no prejudice to the Transacting Parties as it is the legal equivalent of a rejection as the Transacting Parties are given a detailed explanation of the reason for suspension. *See* R.I. Gen. Laws §23-17.14-10(a)(2).

On April 3, 2013, an additional more detailed description of the information necessary to complete the Initial Application was provided to the Transacting Parties. On April 18, 2012, the Transacting Parties filed additional information. On May 3, 2013, the Transacting Parties were again informed that the Initial Application was incomplete. On May 21, 2013, the Departments officially requested that Prime Management be added as a Transacting Party.

An issue that caused a significant amount of delay in this process was the question of whether Prime Management should be included as a Transacting Party on the Initial Application. Early on it was clear to the Departments that Prime Management has a significant role in the operation of Prime and its hospitals. Indeed, Prime Management was the only entity identified by Prime involved with the hospitals that actually had employees. *See* Response to Initial Application Question 38. None of the entities on the corporate chart above the Prime hospitals

[17] Interestingly, the Special Master drafted an appeal of the Departments' suspension of the review even though he thanked the Departments for using the same procedure in the Steward review and invited such procedure again if necessary. The appeal was never filed.

have any employees. *Id.* All of the individuals identified on the PHSI website as management are employed by Prime Management. *Id.* They are working for PHSI pursuant to a management agreement. *See* Initial Application Exhibit 1(f) at pg. 7. Despite these facts, Prime repeatedly objected to the inclusion of Prime Management. Prime flew out its Interim General Counsel at the time, David Grant, to convince the Departments that Prime Management should not be included as a Transacting Party. After that meeting had no impact on the Departments' position that Prime Management be included in the review of the transaction, Prime provided a ten (10) page memorandum plus two corporate charts outlining the inter-relationship between the Prime entities and Prime Management. *See* Initial Application Exhibit 1(f). This Memorandum only solidified the Departments' position that the Initial Application was incomplete without Prime Management, the entity that employs the entire management team of PHSI. After weeks of a number of meetings and communications about Prime Management, Prime finally agreed to include Prime Management as a Transacting Party to the Initial Application in June of 2013. Accordingly, weeks of delay in this review were directly caused by Prime's position that Prime Management not be included in the review.[18]

Finally, on June 28, 2013 the Initial Application was deemed complete with the condition that new copies of the Initial Application be filed incorporating the confidentiality decision made by the Attorney General wherein some documents that were originally requested to be deemed confidential were deemed public. On July 8, 2013, the Transacting Parties filed the final version of the Initial Application with the Departments.

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[18] It should be noted that the applicant in a hospital conversion review initially chooses the entities to include as a required "Transacting Party" pursuant to the Hospital Conversions Act. It was Prime's choice not to either include Prime Management in the first place or to have a conversation with the Departments about whether Prime Management should be included given the unusual inter-relationship between these entities.

During the review, five (5) sets of Supplemental Questions consisting of one hundred and sixty (160) questions were sent to and responded to by the Transacting Parties.

IV. DISCUSSION

As outlined above, the review criteria contained in the Hospital Conversions Act applicable to the Proposed Transaction consists of thirty (30) requirements. For organizational purposes we have addressed them grouped by topic below.

A. BOARD OF DIRECTORS

Numerous provisions of the Hospital Conversions Act involve a review of the actions of the board of directors of the existing hospital.[19] In the Landmark/Steward Decision, the Attorney General provided a review of the action of the board of directors before mastership as well as the Special Master's actions leading to the Landmark/Steward transaction. *See* Landmark/Steward Decision at pg. 13-16. The Attorney General incorporates by reference the findings of the Landmark/Steward decision regarding actions prior to the Special Mastership as well as the actions of the Special Master leading up to the Steward transaction. Actions taken subsequent to the Landmark/Steward Decision are outlined below.

1. Duties of the Board of Directors

As stated in the Landmark/Steward Decision, once the Special Master was appointed, the Boards of Directors of Landmark Medical Center and the Rehabilitation Hospital of Rhode Island were disbanded. Since that time, the Special Master has, in essence, acted in the capacity of the Board of Directors at each hospital, making all major decisions with regard to the fate of Landmark Medical Center and the Rehabilitation Hospital of Rhode Island with court approval of certain actions. The absence of a Board of Directors is not contemplated by the Hospital

[19] *See e.g.*, Hospital Conversions Act, R. I. Gen. Laws §§ 23-17.14-7(c) (3), (4), (5), (8), (9), (10), (11), (13), (14), (15), and (23).

Conversion Act. The Act requires review of the decisions leading up to a conversion to ascertain whether the directors fulfilled their fiduciary duties to the hospital. Because the Special Master has taken on the responsibility of the Board, the Attorney General will review his actions through the lens of the Hospital Conversion Act criteria applicable to the Board of Directors.

The first criteria of the Hospital Conversions Act guiding the review of the actions of the Special Master in pursuing a conversion is governed by R.I. Gen. Laws § 23-17.14-7(c)(3). This section requires review of whether there was "appropriate criteria [used] in deciding to pursue a conversion in relation to carrying out [the hospital's] mission and purposes." With regard to this particular provision, the Special Master was presented with a situation where a conversion was inevitable given the filing of the Petitions for Special Mastership. This process has taken a number of twists and turns in locating a buyer. Again, we will start the discussion of this statutory criteria after the Landmark/Steward Decision and examine the actions leading to the choice of Prime as the successful bidder.

As stated above, there was an involved bid process held in April 2011 in which Prime participated. The criteria necessary to be a successful bidder through the bid process was included in the Court's Order in the Landmark Special Mastership of February 14, 2011. These criteria included:

> (i) The purchase price;
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> (ii) The experience of the Qualified Purchaser in running healthcare facilities, and, if appropriate, financially-distressed healthcare facilities;
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> (iii) The capitalization or access to capital of the Qualified Purchaser;
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> (iv) The minimum amount of capital that the Qualified Purchaser is willing to contractually commit to the successor LMC and/or NRIRMA entity(ies) (exclusive of capital dedicated to the purchase price);
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> (v) A five year pro forma cash flow projection of the successor LMC and/or NRIRMA entity(ies);

(vi) The period of time that the Qualified Purchaser is willing to contractually commit not to sell the assets and business or equity interest in LMC if it becomes the successful purchaser;

(vii) How the Qualified Purchaser intends to meet the healthcare needs of the community currently serviced by LMC including, without limitation, (i) any services that the Qualified Purchaser anticipates terminating; and

(viii) The approximate number of employees that the Qualified Purchaser anticipates retaining.

The bid process in which Prime participated in extensively prior to its withdrawal and that ultimately resulted by default in the asset purchase agreement with Steward (upon which the Prime Asset Purchase Agreement is based) was dictated by the Rhode Island Superior Court. The criteria, considered in broad strokes, sought an entity that could continue to operate Landmark Medical Center and the Rehabilitation Hospital of Rhode Island in as close to their current forms as possible.

The Special Master outlines the steps he took in choosing Prime in detail within the Initial Application. *See* Response to Initial Application Question 13. As outlined therein, he chose to originally speak to Prime because it has already been a "finalist" in the previous bid process. *Id.* He also indicates that he approached Care New England, with whom he had extensive discussion, however, ultimately Care New England decided not to pursue Landmark. Thereafter he approached Lifespan along with Landmark's President Richard Charest and the attorney to the Union, Christopher Callacci. He also states that other members of state government[20] tried to engage with Lifespan to put forth a proposal similar to its previous proposal early on in the Special Mastership that would be a so-called "treat and transfer" model whereby the number of hospital beds would be reduced and certain care would be transferred outside the hospital. The Special Master has stated several times that he does not support a

[20] The Attorney General is not aware of the particulars of these referenced meetings and was not involved in these meetings.

model that results in anything less than a full service community hospital. The Special Master indicated that he approached CharterCare who also did not submit a proposal. In discussion of his choice of Prime, the Special Master emphasizes that when Steward walked away, the issue that he was concerned about was "the financial ability of [Landmark] to continue while a new purchaser was sought and the process re-commenced with a new buyer." *Id.* While the wisdom of this path to locating a buyer remains to be seen, for the purposes of the Hospital Conversion Act review, we find that the Special Master met the minimum requirements of R.I. Gen. Laws § 23-17.14-7(c)(3).

The next section, R.I. Gen. Laws § 23-17.14-7(c)(4) requires a review of "[w]hether the board formulated and issued appropriate requests for proposals in pursuing a conversion." An additional section requires review of "whether the board exercised due care in assigning a value to the existing hospital and its charitable assets in proceeding to negotiate the proposed conversion." *See* R.I. Gen. Laws § 23-17.14-7(c)(10). These two requirements are so intertwined with the Court approved bid process discussed in the previous section, we find such criteria are also met based upon the information set forth above.

2. <u>Board Use of Consultants</u>

Two criteria in the Hospital Conversions Act deal with a board's use of consultants. *See* R.I. Gen. Laws §§ 23-17.14-7(c)(8) and (9):

> (8) Whether the board exercised due care in engaging consultants with the appropriate level of independence, education, and experience in similar conversions; and
>
> (9) Whether the board exercised due care in accepting assumptions and conclusions provided by consultants engaged to assist in the proposed conversion.

As outlined in the Initial Application, the Special Master engaged consultants during his five (5) year tenure.[21] These include lawyers, lobbyists, accountants and other health care professionals. Experts utilized early on in the Landmark Special Mastership, such as PricewaterhouseCoopers and Vector Group did not appear to be utilized at all in the more recent past since the time of the Landmark/Steward Decision. As stated below, the Special Master continued with the same public relations and lobbyists, but they were engaged by Prime. Such consultants are typically not relevant to the Hospital Conversions review criteria on the board's use of consultants as they do not directly provide advice on the proposed conversion. As outlined below, while the Special Master had originally engaged Joshua Nemzoff of Nemzoff & Company ("Nemzoff") to provide assistance in locating Steward and although Nemzoff's assistance was sought again by the Special Master, Nemzoff was hired by Prime instead. It is unclear that the Special Master conferred with any consultants in reaching the deal with Prime. When asked for the names of the individuals who prepared the Asset Purchase Agreement, an attorney from the Special Master's firm was the only individual representing Landmark.[22] While the Special Master requested and received permission to hire the law firm of Nixon Peabody to assist with the Proposed Transaction, his request was months after Prime was chosen and the Prime Asset Purchase Agreement was already approved. Therefore, it does not appear that in this portion of the transaction that the Special Master relied upon the advice of a consultant regarding the choice of Prime. Accordingly, the only consultant that has changed (other than now being employed by Prime) is Nixon Peabody, who was court-approved. The Department of Attorney General has no reason to second guess the judgment of the Court regarding the propriety of the engagement of Nixon Peabody.

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[21] *See* Response to Initial Application Question 60.
[22] Nemzoff was listed, but was presumably working for Prime.

With regard to the care given "in accepting assumptions and conclusions provided by consultants," the Department of Attorney General is not privy to the advice provided by these consultants other than any documents submitted with the Initial Application or through the court process. No final reports regarding Prime were produced. It is unclear if more than advice regarding the regulatory process was provided by consultants in this chapter of the transaction. Accordingly, the Department of Attorney General has found nothing to refute that the Special Master's decision to accept the assumptions and conclusions provided by the consultants, to the extent there were any, was with due care.

3. **Remaining Board Criteria**

Regarding the remaining criteria of this type, the Transacting Parties have not disclosed any management contracts between Prime and any Landmark entity or employee with regard to the Proposed Transaction. *See* R.I. Gen. Laws § 23-17.14-7(c)(14). The only management agreement disclosed is that involving Prime Management's provision of certain services to Prime-Landmark after the Proposed Transaction, as it does with all of its hospitals. With that regard, DOH has mandatory conditions pursuant to the Hospital Conversions Act addressing agreements between affiliates. *See* R.I. Gen. Laws § 23-17.14-28.

The Prime Asset Purchase Agreement does not include consideration that is based upon future or contingent value based upon success of the new hospital. *See* R.I. Gen. Laws § 23-17.14-7(c)(11). The Special Master is an attorney and was also represented by and consulted with various attorneys at his law firm throughout the Special Mastership as well as hiring special outside health care counsel. *See* R.I. Gen. Laws § 23-17.14-7(c)(15). The Department of Attorney General has no information that the "officers, board members, directors, or senior

management deliberately acted or failed to act in a manner that impacted negatively on the value or purchase price." *See* R.I. Gen. Laws § 23-17.14-7(c)(23).

When asked on a conflict of interest form whether the Special Master's law firm, Shechtman Halperin Savage, LLP, had been promised any business relationships with one or more of the Transacting Parties, the answer was in the negative. *See* Supplement 1, Exhibit 31 and R.I. Gen. Laws § 23-17.14-7(c)(13). When asked whether it intends to or has any verbal or written agreement to become a director, officer, employee, consultant, contractor or other representative of one or more of the Transacting Parties, the firm similarly answered in the negative. *Id.* This information addresses R.I. Gen. Laws § 23-17.14-7(c)(13). Therefore, the additional miscellaneous Hospital Conversions Act criteria that must be reviewed regarding board actions have been satisfied.

As outlined above, with regard to the Hospital Conversions Act board criteria, while it is difficult to judge the actions of the Special Master in choosing to bring Prime to the Court for approval, it does not appear, given that Prime participated in the previous bid process and absent any information provided from other potential bidders asserting unfairness of the process, that they have violated any provision of the Hospital Conversions Act.[23]

B. CONFLICTS OF INTEREST

Numerous provisions of the Hospital Conversions Act deal with conflicts of interest.[24] The Attorney General has reviewed the criteria in the Act to determine whether the Transacting Parties and their consultants have avoided conflicts of interest.

[23] *See* Hospital Conversions Act, R. I. Gen. Laws §§ 23-17.14-7(c)(3), (4), (5), (8), (9), (10), (11), (13), (14), (15) and (23).
[24] *See* R.I. Gen. Laws §§ 23-17.14-7(c) (6), (7), (12), (22) and (25) (iv).

1. Conflict of Interest Forms

As part of the Initial Application, certain individuals associated with the Transacting Parties were required to execute conflict of interest forms. These included officers, directors and senior management for Landmark and Prime. Individuals completing the conflict of interest forms were asked to provide information to determine conflicts of interest such as their affiliation with the Transacting Parties, their relationships with vendors and their future involvement with the Transacting Parties. Prime submitted forty-two (42) executed conflict of interest forms and Landmark submitted seventy-five (75) forms. All statements submitted were signed and notarized. *See* Initial Application Exhibit 15(a) and (b) and supplemental responses. After reviewing all forms, the Attorney General determines that none of the submitted forms revealed any conflict of interest.

Two conflict of interest forms from Prime were missing. Neither former Prime CEO Laxman Reddy, the brother-in-law of Prime's current CEO Prem Reddy, nor the former Prime CFO, Roger Krissman provided forms. Both local counsel for Prime and the Attorney General contacted these individuals to obtain forms. While they are no longer employed by Prime, their forms are required. One should not be able to avoid providing a conflict form because of change in employment. Clearly the forms from these individuals are relevant. These individuals have failed to cooperate with the Attorney General's review. Because no forms have been provided the Attorney General has made an inference that a conflict of interest exists with regard to these individuals and any future dealings between Prime and these individuals will be considered suspect and in the event the Attorney General obtains additional information, further action may be taken.

2. Consultants

The Hospital Conversions Act requires a review of the possibility of conflicts of interests with regard to consultants engaged in connection with the Proposed Transaction. R.I. Gen. Laws §§ 23-17.14-7(c)(6) and (7). The Special Master engaged several entities for consultation and advice early in the Mastership, including: (i) PricewaterhouseCoopers LLP ("PWC"), a health industry advisory company; (ii) Vector Group, a health industry advisory company; (iii) JACA Architects; (iv) True North Communications ("True North"), a public relations firm; (v) Kahn, Litwin, Renza & Co. Ltd., an accounting firm; and (vi) Capitol City Group, Ltd. ("Capitol City") a lobbying firm. The majority of these consultants continued to assist the Special Mastership after Steward's withdrawal and into the Proposed Transaction. In the instant matter, the Special Master sought permission to hire an additional consultant, Nixon Peabody LLP, ("Nixon Peabody") health care law attorneys, to assist with this transaction.[25,26]

On behalf of Prime, several consultants were engaged including Government Strategies, Inc., a lobbying firm, and the Law Offices of Michael Sarrao, Capitol City and True North were originally consultants to the Special Master, but were switched over to Prime.[27] *See* Initial Application Response to Question 60. The Transacting Parties agreed to "share" these two consultants.[28] While the switching of consultants from the buyer to the seller during a

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[25] *See* Special Mastership Order granting the Special Master's Amended Petition to Hire Legal Counsel, dated, February 25, 2012.

[26] Nixon Peabody previously represented Steward in its bid to purchase Landmark (albeit in a limited role) previously represented 21st Century Oncology (which operates the Cancer Center at Landmark) and also represented a significant creditor to Landmark, Siemens Medical Solutions USA, Inc. The Superior Court did not find any issue with these previous representations and approved the retention of Nixon Peabody.

[27] It appears that True North was officially switched in March of 2013 and Capitol City in April 2013.

[28] The Initial Application states: "although Prime will pay for their services, relieving the Mastership estate of the costs, nonetheless, Capitol City Group and True North Communications

transaction is inherently suspect, due to the nature of these consultants as public relations and lobbying consultants, so long as the Transacting Parties interests were aligned, this arrangement was acceptable. However, generally the switching of consultants from one side to the other requires additional scrutiny.

a. Nemzoff

Another consultant who has originally contracted with the Special Master and decided to align with Prime later in the transaction is Joshua Nemzoff of Nemzoff & Company. The Special Master engaged Nemzoff as a "Hospital Acquisition Advisor" in the bid process that lead to the Landmark/Steward deal to market the assets and businesses of Landmark to qualified prospective purchasers.[29] The terms of Nemzoff's engagement required him to coordinate negotiations and accomplish a transaction with an identified purchaser. *Id.* Pursuant to the arrangement, Nemzoff would be entitled to an hourly rate for fixed work and for a certain lump sum ("Finder's Fee") if he identified the successful bidder. See Original Nemzoff Agreement at Section IV. His agreement had certain carve-outs to the Finder's Fee for known bidders that were already interested in Landmark, as seemingly the point of the Finder's Fee was an additional bonus for finding the bidder. Nemzoff sought the Finder's Fee in the previous transaction even though his agreement contained a carve-out for Caritas Christi, the predecessor of Steward and Steward was the successful bidder. In the Landmark/Steward Decision, the Attorney General prohibited the payment of the Finder's Fee to Nemzoff. *See* Condition 13 of the Landmark Steward Decision.

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will be available to assist the Special Master whenever necessary." *See* Initial Application Response to Question 60.

[29] *See* Landmark Special Mastership Order Appointing Special Master dated, July 25, 2008 at para. 5 with Letter Agreement between the Special Master and Nemzoff, dated, January 13, 2011. ("Original Nemzoff Agreement").

Even before the Landmark/Steward transaction publicly fell through, the Special Master contacted Nemzoff to determine if he was interested in assisting the Special Master again to identify a buyer for Landmark. *See* Response to Supplement 3, Exhibit 13. Nemzoff responded in an email on August 30, 2012, detailing his displeasure with the Attorney General's prohibition on payment of his Finder's Fee. *Id.* He told the Special Master he would only assist the Special Mastership in finding a new entity to acquire Landmark under certain terms. First, the agreement would be for $500,000.00 and would "apply to anyone that buys the hospital." *Id.* Nemzoff also encouraged the Special Master in this email to consider Prime as the best choice to acquire Landmark commenting that alternatives to Prime are not as "strong and they are not risk takers." *Id.* In another plug for Prime, Nemzoff stated that Prime will likely resolve the Steward debt noting that in comparison to the alternatives "Prime is going to be much more likely to pay." *Id.*

Days after this email exchange, the Special Master's relationship with Nemzoff ended and Nemzoff's relationship with Prime began.[30] A review of this timeframe is essential to determining whether Nemzoff's conduct violates R.I. Gen. Laws § 23-17.14-7 (c)(22), which requires an analysis of "whether the individuals who represented the existing hospital in negotiations avoided conflicts of interest." Within days of advising the Special Master to "talk with Prime," Nemzoff signed an agreement to work for Prime in connection with "any transaction related to Landmark Medical Center and related entities."[31] Nemzoff was present in

[30] *See* Email from the Special Master to his counsel dated, September 15, 2012 wherein he states "Josh is no longer working for us but is now working for Prime." *See* Response to Supplement 3, Exhibit 13 page 1.

[31] *See* Initial Application Confidential Exhibit Number 61(a) - Nemzoff Financial Advisory and Consulting Agreement dated, September 11, 2012. This agreement was deemed confidential along with the other agreements filed with the consultants. At the request of the Attorney General the parties consented to this information being deemed public.

court on October 31, 2012 when the Special Master sought permission for approval of the Prime Asset Purchase Agreement.

The Attorney General reviewed the agreement between Nemzoff and Prime ("Nemzoff-Prime Agreement").[32] This agreement was not for any certain term, but only included an engagement regarding Landmark. *Id.* The fee included in this agreement was $250,000. *Id.* Of interest, Nemzoff began including the following language in his new agreements after the Attorney General prohibited his Finder's Fee in the Landmark/Steward transaction:

> In the event that any regulatory or judicial entity attempts to stop the Company from paying these fees or makes any approval of this transaction contingent upon not paying these fees, then the Company shall not proceed with the closing of this transaction.

See Supplement 2, Financial Advisory and Consulting Agreement between Prime and Nemzoff filed in the New Jersey Attorney General Application for the transfer of ownership of St. Michael's Medical Center at 005037-005039. The Attorney General notes that the legal enforceability of such provision is questionable.

For unknown reasons another agreement between Nemzoff and Prime ("Nemzoff-Prime Long Term Agreement") was entered on March 27, 2013 for the time frame from April 15, 2013 to April 15, 2014. *See* Supplement 4, Response to Question S4-2, Exhibit 2. It outlined a scope of services that included "regular and customary consulting advice concerning financial matters relating or pertinent to [PHSI]" and included an up-front fee of $500,000 "to cover all of the services that have been rendered by the Consultant up to and including [the] date [of the agreement]." *See* Nemzoff-Prime Long Term Agreement at para 3(a). For the remainder of the

[32] *See* Initial Application Confidential Exhibit Number 61(a) - Nemzoff Financial Advisory and Consulting Agreement dated, September 11, 2012. This agreement was deemed confidential along with the other agreements filed with the consultants. At the request of the Attorney General the parties consented to this information being deemed public.

year, Nemzoff was to be paid $50,000 per month. *See* Nemzoff-Prime Long Term Agreement para. 3(b).

After this agreement was signed, a payment was made by Prime to Nemzoff in the amount of Five Hundred Fifty Thousand Dollars ($550,000). *See* Responses to Supplemental Question S1-41 and S3-3. A month following this payment, Prime reported that their relationship with Nemzoff was terminated. *See* Response to Supplemental Question S1-41.

Overall, Nemzoff's role in this transaction since the withdrawal of Steward has been questionable. In the previous transaction, his agreement with the Special Master was approved by the Court and he clearly participated throughout the bid process and throughout the Landmark/Steward transaction. It is not appropriate for a consultant of the nature of Nemzoff to switch from Landmark to one of the competing bidders that he was charged with reviewing in the original transaction. From the start of this transaction, he lobbied the Special Master to choose Prime and then shortly thereafter was engaged by Prime for $250,000 regarding work with Landmark. Thereafter for reasons that are not clear, he was given another contract for more money, slightly in excess of the original prohibited Finder's Fee he felt he was entitled to from the Landmark/Steward deal. While it is possible that the Special Master reviewed other potential bidders and independently decided that Prime was the best candidate for the acquisition of Landmark, Nemzoff's switch to Prime is a conflict of interest. In certain other circumstances and with additional facts with regard to the money paid by Prime, a relationship such as the one between Prime and Nemzoff could have resulted in denial of an Initial Application.

b. Attorney Special Masters

Aside from the expenses Prime has incurred in acquiring Landmark,[33] the Attorney General notes that the Special Mastership has generated a significant amount of income from this case. For example, the amount requested by the Special Master in his Interim Reports on all three special masterships totals approximately $4,871,966.93.[34] In addition, the Special Master hired his own firm, Schectman, Halperin, Savage, LLP, for litigation ancillary to the Mastership proceeding. As was discussed in the Landmark/Steward Decision, the issue of the inherent conflicts that arise from special mastership involving an attorney special master are intrinsic in the process and will continue to be grappled with in future proceedings.

3. Negotiations And Conflicts

With the exception of the discussions outlined above, there was no information provided which suggests that the individuals who represented the existing hospital in negotiations of the Proposed Transaction had any impermissible conflicts of interest.[35]

4. Sale Proceeds And Conflicts

As contemplated by the structure of the purchase price outlined in the Asset Purchase Agreement, there will be no proceeds from the Proposed Conversion. Therefore, there is no need

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[33] Pursuant to an estimated accounting provided in Response to Initial Application Question #48, exclusive of the Nemzoff settlement, minimally Prime estimates it will spend $266,000 on attorneys' fees, consultants, travel and additional costs in connection with acquiring Landmark.
[34] This amount is based upon the Landmark Medical Center 1st to 40th Interim Reports and Fee Requests of the Special Master as well as the Fee Requests regarding Landmark Health Systems and the Rehabilitation Hospital of Rhode Island. The Attorney General is aware that the entire amount of those fees is not finally determined. The Special Master has agreed to a few of the Attorney General's requests to remove fees and some amounts in dispute remain outstanding. However, this is the amount that was requested.
[35] R.I. Gen. Laws § 23-17.14-7(c)(22).

to address whether the Transacting Parties have appropriately provided for the disposition of proceeds.[36]

5. Prime Conflicts Of Interest

In response to various questions, Prime has indicated that no final determinations have been made regarding future positions at Prime-Landmark.[37] Given that response, the Attorney General cannot determine if future conflicts of interest will exist.[38]

C. VALUE OF TRANSACTION

The following Hospital Conversions Act criteria deal with valuation of the Proposed Transaction. *See* R.I Gen. Laws §§ 23-17.14-7 (c)(17), (18) and (24):

> (17) Whether the proposed conversion contemplates the appropriate and reasonable fair market value;
>
> (18) Whether the proposed conversion was based upon appropriate valuation methods including, but not limited to, market approach, third party report or fairness opinion; and
>
> (24) Whether the formula used in determining the value of the existing hospital was appropriate and reasonable which may include, but not be limited to factors such as: the multiple factor applied to the "EBITDA" – earnings before interest, taxes, depreciation, and amortization; the time period of the evaluation; price/earnings multiples; the projected efficiency differences between the existing hospital and the new hospital; and the historic value of any tax exemptions granted to the existing hospital.

Given their relevant expertise in this area, the Attorney General consulted with its expert, Health Strategies & Solutions, Inc., ("HS&S"), in making a determination regarding valuation. According to the analysis of HS&S:

> According to the Asset Purchase Agreement, Prime Healthcare Services, Inc. (Prime) will expend a total of $43.3 million (subject to various adjustments), plus the value of Net Working Capital as of the closing date for the acquisition of [Landmark]. Prime states that it will also spend $4.5 million in the first five years following closing for physician recruitment to meet the needs of the community.

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[36] *See* R.I. Gen. Laws § 23-17.14-7(c)(25)(iv).
[37] *See* Initial Application Response to Questions 35, 36, 39 and 42.
[38] R.I. Gen. Laws § 23-17.14-7(c)(12).

> In addition, Prime expects to provide at least $15.0 million over this period for "routine replacements" at [Landmark].
>
> A third party valuation analysis or fairness opinion was not completed with regard to the proposed transaction. Because LHS has had negative earnings before interest, taxes, depreciation, and amortization (EBITDA), margins over each of the past several years, a multiple of earnings calculation, yields a negative value for [Landmark].
>
> The purchase commitment from Prime for the acquisition of [Landmark] is fair and reasonable. This is based on review of available documentation, analysis of [Landmark]'s current and historical operating performance, and interviews and discussions with numerous individuals who participated in the negotiation processes leading up to and specifically related to this transaction.

While it was clear at the public informational meetings that the value of Landmark Medical Center and the Rehabilitation Hospital of Rhode Island to the people of Northern Rhode Island is without measure, this does not translate into cash proceeds. It is clear this is an unusual situation. Typically, there are proceeds in a hospital conversion, however, the Proposed Transaction is designed such that Prime will pay certain obligations of Landmark Medical Center and the Rehabilitation Hospital of Rhode Island as well as provide future promises of capital. In determining whether the valuation of the Proposed Transaction is correct, the report of HS&S regarding the financial status[39] of Landmark Medical Center and the Rehabilitation Hospital of Rhode Island as steadily deteriorating is also of assistance. Further, the bid process before the Court during the Special Mastership and the previous bid by Steward that was approved by the Court were instructive as to what the relevant market would pay for Landmark Medical Center and the Rehabilitation Hospital of Rhode Island.

[39] *See* Final Report of HS&S, Assessment of Operating and Financial Performance (dated, October 25, 2013).

Accordingly, given the information provided by HS&S, as well as the amount of offers of other bidders through this five (5) year process, the criteria regarding valuation of the Proposed Transaction has been met.

D. CHARITABLE ASSETS

The Department of Attorney General has the statutory and common law duty to protect charitable assets within the State of Rhode Island.[40] In addition, the Hospital Conversions Act specifically includes provisions dealing with the disposition of charitable assets in a hospital conversion generally to ensure that the public's interest in the funds is properly safeguarded. With regard to the charitable assets of Landmark, the landscape has not changed significantly from the time when they were reviewed and outlined in the Landmark/Steward Decision.

1. Disposition of Charitable Assets

In the Initial Application, the Transacting Parties identified the amount of $33,331.55 in restricted funds (the "Restricted Funds"). *See* Response to Supplemental Question S5-2, Exhibit 2.[41] Of such amount, $26,723 is attributable to the HRSA Hospital Preparedness Program ("HRSA Grant").[42] *Id.* The remainder of the Restricted Funds are designated for the Heart Center and the Cancer Center. *Id.* There are also charitable funds identified as "Unrestricted Funds" totaling $19,468. *Id.*

In addition, as outlined in the Landmark/Steward Decision, a large amount of charitable assets previously held by Landmark were amounts it reported that it received from an endowment fund, the John R. Higgins Residuary Trust. Landmark previously provided

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[40] *See e.g.*, R.I. Gen. Laws § 18-9-1, *et seq.*

[41] This Exhibit consists of Initial Application Exhibit 28(b)(2) updated as of September 30, 2013.

[42] It was represented in the previous transaction that it is possible for the HRSA grant to be transferred.

documentation that the funds in the Higgins Trust that were disbursed to Landmark in 2007 were exhausted by Landmark, with the last amounts being spent in 2011.[43] The Attorney General found in the Landmark/Steward Decision that there is no violation of the Charitable Trust Act regarding the Higgins Trust based upon the information that was provided.[44]

With regard to the Restricted Funds, per the Hospital Conversions Act, in a hospital conversion involving a not-for-profit corporation and a for-profit corporation, it is required that any endowments, restricted, unrestricted and specific purpose funds be transferred to a charitable foundation.[45] In furtherance of that requirement, Landmark has indicated that it intends to transfer all currently held specific purpose and restricted funds to the Rhode Island Foundation,[46] which will use the funds in accordance with the designated purpose. With an appropriate agreement with the Rhode Island Foundation to manage these assets, the Attorney General finds that the Proposed Transaction will not harm the public's interest in the property given, devised or bequeathed to Landmark for charitable purposes.[47] The Attorney General notes that the Rhode Island Foundation is specifically mentioned as an appropriate entity to manage funds as a result of a hospital conversion.[48]

2. <u>Maintenance of the Mission, Agenda and Purpose of Landmark</u>

The Hospital Conversion Act at R.I. Gen. Laws § 23-17.14-7(c)(16) and R.I. Gen. Laws § 23-17.14-7(c)(25)(iii) requires consideration of the following:

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[43] *See* Landmark/Steward Decision, pg. 25-26
[44] *See* R.I. Gen. Laws § 23-17.14-7(c)(26).
[45] R.I. Gen. Laws § 23-17.14-22(a).
[46] *See* Response to Supplemental Question S2-25
[47] R.I. Gen. Laws § 23-17.14-7(c) (1).
[48] R.I. Gen. Laws § 23-17.14-7-22(e).

- Whether the proposed conversion results in an abandonment of the original purposes of the existing hospital or whether a resulting entity will depart from the traditional purposes and mission of the existing hospital such that a cy pres proceeding would be necessary; and
- Whether the mission statement and program agenda will be or should be closely related with the purposes of the mission of the existing hospital.

According to the original Articles of Incorporation for Woonsocket Community Health, Inc.,[49] the organization's purpose was to:

> [support] the advancement of the health of all persons through improving the knowledge and practice of medicine, surgery, nursing, health planning, and other activities related the care and treatment of such persons, and to support and encourage charitable, scientific, and educational services and programs which are consistent with such purposes…

See Initial Application Exhibit 10(a).

According to information provided in supplemental responses, the current mission statement of Landmark Medical Center is to "provide a continuum of exceptional quality, patient-centered services that improve health in a culturally competent manner that is creative and consistent with values aligned with our diverse communities."[50] The mission statement of the Rehabilitation Hospital of Rhode Island is of a similar nature: "[C]ommit[ment] to providing competent and compassionate comprehensive medical rehabilitation services, respectful of every patient's dignity and cultural values, assuring patient's of achieving their greatest functional outcomes in the most cost-effective manner."[51]

Prime provided as its mission statement: "Prime Healthcare Services endeavors to provide comprehensive, quality healthcare in a convenient, compassionate and cost effective

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[49] Woonsocket Community Health Inc. was the sole member of Woonsocket Hospital, which later became Landmark Medical Center. *See* Initial Application Response, Exhibit 10(a).
[50] *See* Response to Supplemental Question S5-4.
[51] *Id.*

manner." [52] While implied in Prime's for-profit status that profit is an issue that will be considered, Prime's stated vision is in keeping with the current purposes of Landmark Medical Center and the Rehabilitation Hospital of Rhode Island.[53] Upon the closing of the Proposed Transaction, the mission statements of Landmark Medical Center and the Rehabilitation Hospital of Rhode Island will be changed to be identical to Prime's Mission Statement. *Id.*

The Attorney General has also considered that Prime has purchased a number of distressed hospitals as part of its business model and has stated publically that it has never closed or sold any of its hospitals. *See* Testimony of Luis Leon, Transcript of Public Meeting, September 30, 2013, at pg 5, lines 12-18. Prime represents that it purchased its first hospital in 2001 and now owns twenty-three (23) hospitals through PHSI and its affiliated foundation. *See* Prime Healthcare Services Presentation to the Health Services Council, dated, July 9, 2013 at pg. 18. *See also,* Initial Application Question 1. Although there is no evidence that the Proposed Transaction will differ significantly from the stated purposes of Landmark Medical Center and the Rehabilitation Hospital of Rhode Island, it is necessary that a cy pres be filed and granted to ensure the proper utilization of the remaining restricted funds and because this hospital conversion includes the conversion of two non-profit entities' assets for use by for-profit entities.

In further consideration of whether "a resulting entity will depart from the traditional purposes and mission of the existing hospital," the Attorney General reviewed Prime's intention to work with hospital leaders and community representative to develop a Community Benefits Advisory Council. *See* Response to Initial Application Question 33. Included therein, Prime "will conduct a comprehensive community health needs assessment for those communities within the hospitals' primary service areas." *Id.* The Community Benefits Advisory Council will

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[52] *Id.*

[53] R.I. Gen. Laws §§ 23-17.14-7(c)(16) and (25)(iii).

use this assessment to develop a "community benefits plan that identifies target populations, specific programs and activities that address the identified assessment, and measure short-and long-term goals for each program." *Id.* Prime represents that each year a report will be produced that will describe "the ascribed community benefits programs, including those goals, outcomes, and expenditures." *Id.* This report will be available to the public. *Id.*

Further, Rhode Island law requires that all licensed hospitals, whether non-profit or for-profit, provide unreimbursed healthcare services to patients with an inability to pay.[54] Therefore, Prime will be required even as a for-profit hospital to provide a certain amount of charity care. In addition, Prime has provided information in the Initial Application demonstrating its provision of charity care in its other acquired hospitals. [55]

Finally, in consideration of whether the new entity will operate with a similar purpose, pursuant to Section 10.3 of the Asset Purchase Agreement entitled "Maintenance of Services" Prime has agreed to maintain Landmark Medical Center as an acute care hospital with an open and accessible emergency department and an independent medical staff.[56] There is no guarantee that services will continue as they have in the past. As with any merger, it is likely that some changes will take place after Prime takes over the hospitals even though Prime has stated that it "does not have any plans for changes to the existing services at LMC or RHRI." *See* Initial Application, Response to Question 53(b). Prime also states that it has not "had the opportunity to meet with [local] physicians in any meaningful way concerning such changes." *Id.* In addition, Prime states in another response, that it "believes that plans to develop or change the existing services at a hospital or to develop new services can only be determined after review of

[54] R.I. Gen. Laws §§ 23-17.14-15(a)(1), (b) and (d).
[55] *See* Initial Application Exhibit 32(a).
[56] *See* First Amendment to Asset Purchase Agreement at para. 2.

sufficient data and input from local management, local physicians and other health providers, and local community leaders." *See* Response to Initial Application Question 57. It also states that although services are being reviewed, it has "not yet made any final determinations regarding whether such departments and/or services may need to be changed, by eliminating, significantly reducing or enhancing such departments, and/or service in the interest of operational efficiency following the proposed conversion." *See* Response to Initial Application Question 73. Accordingly, the Proposed Transaction does include a risk that Prime will change the services provided at Landmark.

3. Foundation for Proceeds

In addition to dealing with charitable assets, the Hospital Conversions Act requires an independent foundation to hold and distribute proceeds from a hospital conversion consistent with the acquiree's original purpose.[57] With regard to the Proposed Transaction, the Asset Purchase Agreement does not include a purchase price that will produce traditional proceeds as it is structured upon payment of certain obligations and commitment to future investments in the hospital. Accordingly, R.I. Gen. Laws § 23-17.14-22 does not require a foundation for receipt of proceeds.

E. TAX IMPLICATIONS

There are three criteria in the Hospitals Conversions Act that deal with the tax implications of the Proposed Transaction. [58] Currently, Landmark Medical Center and Landmark Health Systems are non-profit corporations organized pursuant to Rhode Island law. Northern Rhode Island Rehab Management Associates, L.P. is a limited partnership organized pursuant to the laws of Delaware. Upon the purchase of their assets by Prime, the resulting entities will be

[57] R.I. Gen. Laws § 23-17.14-22(a) and R.I. Gen. Laws § 23-17.14-7(c)(16).
[58] *See* R.I. Gen. Laws §§ 23-17.14-7(c)(20), (21) and (25)(ii).

for-profit entities and no longer immune from certain tax obligations. Clearly, this has an impact on the tax status of these entities.[59] This transaction represents the first full service hospital in Rhode Island to change from a non-profit to a for-profit hospital. It is a marked change in how hospitals in Rhode Island have traditionally been held. While some may be cautious about allowing a for-profit entity to purchase Landmark Medical Center and Rehabilitation Hospital of Rhode Island, in the instant matter this decision was not made in a typical fashion, but was made by a Special Master with approval of the Rhode Island Superior Court in a situation involving a distressed hospital and only one potential bidder. Such bidder was selected after the original for-profit bidder withdrew after a year's process towards a transaction and after four (4) years of the hospitals being in Special Mastership. Thereafter, Prime was the only option offered to the Superior Court for approval. Accordingly, the wisdom of choosing a for-profit company to purchase a non-profit hospital is not a matter that warrants in-depth consideration given the circumstances.

With regard to tax implications, in supplemental questions Prime was asked to provide an estimate of real estate taxes it will pay upon closing the Proposed Transaction. *See* Response to Initial Application Question 54. Prime responded that it expected to pay $946,000 in real estate taxes to the City of Woonsocket.[60] *See* Response to Supplemental Question S1-88. It appears that this figure is based upon a previous report from when the Caritas Christi deal was in the

[59] The question posed by R.I. Gen. Laws § 23-17.14-7(c)(21) is whether the tax status of the existing hospital is "jeopardized." This characterization does not apply to the Proposed Transaction as not only is it jeopardized, it is knowingly being changed from non-profit to for-profit.

[60] No real estate taxes will be paid by Prime to North Smithfield for RHRI as the real estate is owned by another entity and is not being purchased in this transaction. *Id.*

works several years ago.[61] *See* Response to Supplemental Question S2-13. This document calculated an estimated tax to Woonsocket for Landmark Medical Center of approximately $2.2 Million Dollars based upon various assumptions and including the planned improvements contemplated by the Caritas Christi Asset Purchase Agreement. The real estate tax portion is stated as $946,000. *Id*

A review of the public record reveals that Landmark Medical Center currently has an assessed value of $27,370,600.[62] Accordingly, using the available documents, it appears that the tax payable to Woonsocket will be significant.[63] The payment by Prime of substantial real estate taxes is a significant factor in this Department's decision with regard to the Proposed Transaction. Prime has indicated that it has not and will not seek a tax treaty from the City of Woonsocket. *See* Response to Supplemental Questions S1-89 and S3-6. An estimate of $1,965,834 in property and tangible tax was also provided, this amount including the additional capital expenditures contemplated by the Asset Purchase Agreement. *See* Response to Supplemental Question S3-6 and Exhibit 6. The payment of real estate taxes to Woonsocket, that so desperately needs the resources, is a clear, tangible benefit directly resulting from the Proposed Transaction. While it remains a question whether this benefit will outweigh the possible risks of allowing Rhode Island hospitals to be purchased by for-profit entities remains to be seen, payment of real estate taxes to Woonsocket certainly represents a positive attribute of Prime.

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[61] *See* Landmark Medical Center – Pro Forma Property and Tangible Tax Calculation (dated, April 30, 2010).
[62] *See* http://gis.vgsi.com/woonsocketri/Parcel.aspx?pid=10626 (last accessed October 24, 2013).
[63] The Attorney General has not verified any of the tax estimates contained in this Section and has provided them for illustration only. The final amount will be determined by the City of Woonsocket.

In addition to real estate taxes, typically Prime would be required to pay Rhode Island sales and use tax in certain situations. *See* R.I. Gen. Laws § 44-18-1 *et seq.*, and 44-19-1, *et. seq.* However, in 2010, legislation was passed to exempt Landmark Medical Center and any successor in interest from payment of such taxes for the term of 12 years.[64] Accordingly, Prime will be exempt from significant Rhode Island sales and use tax that it would have owed until 2022. As a result, Prime has already realized favorable tax treatment provided to no other existing hospital in Rhode Island.[65]

As for the remaining review criteria contained in R.I. Gen. Laws §23-17.14-7(c)(20), regarding "whether the conversion is proper under applicable state tax code provisions," in response to Question 54 of the Initial Application, the Transacting Parties have indicated that "Prime has not prepared or received any opinions, reports or memoranda addressing the state and federal tax implications of the proposed conversion." Accordingly, the Attorney General makes no finding with regard to whether the Proposed Transaction is proper under applicable state tax code provisions. Regarding the tax status of the entity receiving the proceeds, no proceeds are contemplated and the new entities will be for-profit. *See* R.I. Gen. Laws § 23-17.14-7(c)(25)(ii).

F. NEW ENTITY

The Attorney General must review certain criteria pursuant to the Hospital Conversions Act that deals with the corporate governance of the new hospitals after the completion of the Proposed Transaction.[66] Below is an outline of the review of such requirements.

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[64] The result of such legislation was a new statutory provision codified at R.I. Gen. Laws § 23-17.25-2.

[65] This considerable concession bolsters the position that a tax treaty regarding real estate taxes is not necessary.

[66] *See e.g.*, Hospital Conversions Act, R.I. Gen. Laws §§ 23-17.14-7(c)(25) (i), (v), (vi), (vii), (viii), and (ix).

1. **Bylaws and Articles of Incorporation**

One issue that must be examined is whether the new entity has bylaws and articles of incorporation. The new corporate entity that will purchase the assets of Landmark Medical Center and the Rehabilitation Hospital of Rhode Island is Prime Healthcare Services-Landmark, LLC. Prime-Landmark, is a Delaware corporation incorporated on September 19, 2012. *See* Initial Application Exhibit 10(f). The current bylaws[67] for Prime-Landmark were provided by the Transacting Parties. *Id.* After DOH raised concerns that the current bylaws did not comply with the Rhode Island regulations for licensure of hospitals, revised bylaws that will be adopted post-closing were provided. *See* Letter from Cynthia Warren (enclosing revised bylaws) dated, July 8, 2013. These revised bylaws will be considered the Prime-Landmark Bylaws for purposes of this Decision as they are the anticipated governing documents as required by DOH. Therefore, bylaws and articles of incorporation have been provided for Prime Landmark.

Prime Management is identified as the entity that will operate Landmark and Rehabilitation Hospital of Rhode Island. Prime Management is a California corporation incorporated on February 24, 2004. *Id.* Bylaws for Prime Management were provided in the Initial Application. *See* Initial Application Exhibit 10(cc). Therefore, bylaws and articles of incorporation have been provided for Prime Management. In addition, the relevant corporate documents have been provided for Prime Healthcare Holdings, Inc. and Prime Healthcare Services, Inc. *See* Initial Application Exhibits 10(gg) and 10(b). Accordingly, R.I. Gen. Laws § 23-17.14-7(c)(25)(v) has been satisfied.

[67] Typically a limited liability company does not have bylaws. However, Prime-Landmark has bylaws, as well as an operating agreement.

2. Board Composition

In addition to bylaws and articles of incorporation, specific criteria that must be considered regarding the new corporate entities include analysis of the composition of the new boards. Specifically, the Hospital Conversions Act requires review of:

> (vi) whether the board of any new or continuing entity will be independent from the new hospital;
>
> (vii) whether the method for selecting board members, staff, and consultants is appropriate;
>
> (viii) whether the board will comprise an appropriate number of individuals with experience in pertinent areas such as foundations, health care, business, labor, community programs, financial management, legal, accounting, grant making and public members representing diverse ethnic populations of the affected community; and
>
> (ix) whether the size of the board and proposed length of board terms are sufficient.

See R.I. Gen. Laws §§ 22-17.14-7(c)(25)(vi), (vii), (viii) and (ix).

In Response to Question 7 of the Initial Application, the Transacting Parties state:

> Prime-Landmark has not yet identified those individuals who will serve on the local governing boards for Landmark Medical Center and Rehabilitation Hospital of Rhode Island. Nonetheless, the local governing boards will be comprised of local community leaders, medical staff members, and hospital management. Prime-Landmark will seek input from all stakeholders as to the section of local governing board members.

The response further states:

> After the conversion, Prime-Landmark will be a wholly-owned subsidiary of PHSI, and the Board of Directors of PHST will serve as the Board of Directors of Prime-Landmark. Prime-Landmark will form local governing boards at Landmark Medical Center and Rehabilitation Hospital of Rhode Island. Each governing board will have five (5) to eleven (11) members including local physicians and community leaders.

According to lists of the members of the board of directors for the other Prime hospitals, no other Prime hospital has less than five (5) board members.[68] *See* Response to Initial Application Question 7. Section 3 of the Prime-Landmark Bylaws outlines the requirements for members of the Prime-Landmark Board of Directors, including the mechanism via which members are appointed. Criteria that is supposed to be considered includes:

(a) Willingness to give as much time as is reasonably requested;
(b) Availability to participate actively in Governing Board and committee activities, especially those activities where the Governing Board Member has a special interest and expertise;
(c) Experience in organizational and community activities;
(d) Proficiency in the art of managing people and property; and
(e) Integrity, objectivity, and loyalty.

See Section 3.2. The Prime-Landmark Bylaws require no less than three (3) so-called Regular Members. (Section 3.2) Ex-officio Members are also contemplated, including certain hospital staff members. *Id.* Only Regular Members are entitled to vote. *Id.* While Board Members have significant authority (Section 3.8), PHSI retains broad control over certain aspects of Prime-Landmark. For example, pursuant to Section 3.3, PSHI chooses all board members. It may also remove members without cause (Section 3.5). The Chair of the PSHI Board, currently Dr. Reddy, automatically serves as the Chair of the Prime-Landmark Board (Section 4.1) and appoints all committee members (Section 3.4). Further, certain powers are expressly reserved to PSHI (Section 6.7). These include: (i) election of regular members of the Governing Board; (ii) removal of the CEO; (iii) approval of all capital and operating budgets; (iv) approval of any loan or other facility from a financial institution; and (v) approval of any budgeted expenditure in excess of such amount as determined, from time to time, by [PHSI].

[68] The five (5) member Board of Directors for PHSI serves as the Board of Directors for the local PHSI hospitals. The local governing boards for each hospital have no less than seven (7) members. *Id.*

Accordingly, the composition of the boards of Landmark Medical Center and the Rhode Island Rehabilitation Hospital of Rhode Island boards is not sufficiently clear to either ensure the independence from the hospital or the diversity of experience required by the Hospital Conversions Act. *See* R.I. Gen. Laws §22-17.14-7(c)(25)(vi) and (viii). No method for selecting board members has been provided other than they will be selected by PHSI and certain criteria will be considered. *See* R.I. Gen. Laws §22-17.14-7(c)(25)(vii). No concrete number of board members has been provided and no number of directors has been required to be from the community. Therefore, the Hospital Conversions Act criteria regarding the Boards of the new entities have not been met.

G. CHARACTER, COMMITMENT, COMPETENCE AND STANDING IN THE COMMUNITY

An important and encompassing portion of the Hospital Conversions Act review criteria requires review of "[w]hether the character, commitment, competence and standing in the community, or any other communities served by the transacting parties are satisfactory" *See* R.I. Gen. Laws § 23-17.14-7(c)(28). As stated above, a PHSI subsidiary incorporated specifically for this Proposed Transaction, Prime-Landmark, is buying the assets of Landmark. Prime Management is going to provide certain management services to Landmark. PHSI will have significant control over Landmark and is the owner/operator of twenty-three (23) other hospitals. Therefore it is the relevant entity to review in accordance with the requirements of this statutory provision.

1. Character

As stated above, PHSI was incorporated on March 27, 2000. *See* Initial Application Exhibit 10(bb). Prime represents that it purchased its first hospital in 2001 and now owns twenty-three (23) hospitals through PHSI and its affiliated foundation. *See* Prime Healthcare

Services Presentation to the Health Services Council, dated, July 9, 2013 at pg. 18. *See also,* Initial Application Question 1. The first Prime hospital was Desert Valley Hospital that Dr. Reddy has indicated he built from the "ground up." Transcript of Health Services Council, July 9, 2013, Testimony of Prem Reddy, at pg. 35, lines 7-11. As stated above, Prime indicates that it has never sold or closed a hospital that it has purchased.

On the other hand, there are some issues of concern to the Attorney General regarding Prime. The first is a recent Resolution Agreement with the Office of Civil Rights and the other is an outstanding subpoena issued by the Department of Justice and the Office of Inspector General. These issues will be discussed in turn below.

a. Office of Civil Rights Resolution Agreement

The U.S. Department of Health and Human Services, Office for Civil Rights ("OCR") initiated a compliance review of a PHSI hospital, Shasta Regional Medical Center ("Shasta") in January 2012. *See* Resolution Agreement between Shasta and OCR, Exhibit 50 to Supplement 1. The review was prompted by an article in the *Los Angeles Times* that indicated two Shasta senior leaders discussed medical services provided to a patient with the media without valid written authorization. *Id.* at pg. 1. This investigation concluded in June 2013 with a Resolution Agreement whereby Shasta paid a resolution amount of $275,000. *Id.* The Resolution Agreement contains the indicated findings of the OCR investigation, specifically, that the following alleged conduct occurred in December 2011 without the patient's authorization:

> (1) SRMC (through its parent company) sent a letter to *California Watch*, detailing a patient's medical treatment and lab results;
>
> (2) two SRMC senior leaders met with an editor of *The Record Searchlight* and discussed a patient's medical record; and
>
> (3) SRMC sent a letter to the *Los Angeles Times* concerning information about the patient's treatment.

Id. at pg. 2.

According to OCR, a December 20, 2011 e-mail was sent to the entire Shasta medical staff and workforce, approximately 785 to 900 individuals, that described the patient's medical condition, diagnosis and treatment. *Id.* The Agreement was not an admission of liability by Shasta. *Id.* Included in the Resolution Agreement, Shasta agreed to comply with a Corrective Action Plan and to appoint a Compliance Representative. *Id.* at pg. 3. While operation of a hospital is fraught with the possibility of running afoul of the privacy laws, this Resolution Agreement involved a situation appearing to include several serious lapses in judgment and included a significant penalty amount.

b. DOJ/OIG Subpoena

In response to Question 1 of the Rhode Island Change in Effective Control Application, Prime revealed that a subpoena from the Department of Justice and Office of Inspector General was issued to various Prime-affiliated hospitals/entities. Prime would not provide a copy of the subpoena stating that it was prohibited from doing so by language in a cover letter to the subpoena. *See* Response to Supplemental Question S1-63. Instead, Prime provided a lengthy so-called "white paper" outlining its response to allegations that apparently they felt could be deduced from the requests in the subpoena, namely that the Prime hospitals have higher rates of certain disease codes. *See* Response to Supplemental Question S1-62 and Exhibit 62(a). Prime specifically addressed its coding of two conditions, septicemia and kwashiorkor, in this white paper. *See* Response to Supplemental Question S1-62 and Exhibit 62(a).

The Department of Attorney General has been in contact with the Department of Justice regarding the subpoena. At this point, it appears that the Department of Justice investigation remains ongoing. Accordingly, the Department of Attorney General is in a difficult situation.

On one hand, Prime is subject to a criminal subpoena from the Department of Justice and Officer of Inspector General. On the other hand, however, at this point, it is only a subpoena and no resolution either positive or negative has taken place prior to the issuance of this Decision. There is no way to predict the outcome of any particular investigation. Clearly, a definitive result one way or another would be helpful in making a decision under the Hospital Conversions Act; however, we do not have that luxury. Therefore, we must view the subpoena simply as what it is, an inquiry from a federal agency.

Prime has indicated that it is diligent regarding providers appropriately documenting all issues involved in a certain episode of care. Prime has hired professionals to train its staff on documentation. *See* Response to Supplemental Question S3-12. How a procedure is coded may impact both quality scores associated with a hospital's performance as well at the reimbursement rate at which the hospital is paid. If the Office of Inspector General had found that Prime's coding has crossed the line from diligent documentation to illegal activity, that fact would be considered, but not conclusive on the character of Prime. As of this date, however the Attorney General is unaware of any finding by the OIG and therefore, must only consider that there is an outstanding issue with regard to coding, but such issue is, of yet, unresolved.

2. <u>Commitment</u>

Pursuant to the Asset Purchase Agreement, Prime-Landmark has agreed to a number of financial commitments, including a $30 Million Dollars in capital expenditures to improve Landmark. *See* Asset Purchase Agreement, Section 10.1 and 1.6(a). However, only $10 Million of such amount is guaranteed by PHSI. See, Asset Purchase Agreement Section 10.4.[69] These

[69] Because Prime-Landmark is initially no more than a shell corporation to hold the assets of Landmark, the Attorney General requested at the time of the hearing on the approval of the Asset Purchase Agreement for the entire amount of the capital expenditures to be guaranteed by PHSI.

improvements include investing in technology, equipment and/or expanded services. *See* Response to Initial Application Question 57(d). Also, included in the Asset Purchase Agreement is a commitment to invest no less than $4.5 million toward physician recruitment during the first five (5) years. *See* Asset Purchase Agreement, Section 1.7(a). Further, the Asset Purchase Agreement contains a commitment to invest no less than $15 million towards routine equipment replacement during the first five (5) years. *See* Asset Purchase Agreement Section 1.7(b). The Asset Purchase also includes other commitments in lieu of cash that will have to be performed by Prime-Landmark prior to Closing. *See* Asset Purchase Agreement, Section 1.6. Other than financial commitments, Prime has promised that Landmark will continue as an acute care hospital for the term of five (5) years with an open and accessible emergency room and an independent medical staff. *See* Asset Purchase Agreement Section 10.3.

3. Competence

As stated above, Prime has a track record of operating twenty-three (23) hospitals in other states, one for twelve (12) years. The term competence can have multiple meanings and connotations. The Department of Attorney General reviewed the relevant competence with a focus on the ability to successfully operate the hospital after the Proposed Transaction. The central function of operating hospitals is patient care. The Rhode Island Department of Health's review focuses more directly on health services and has identical review criteria regarding this topic,[70] therefore, the Department of Attorney General will rely on and defer to their expertise and experience relating to PHSI's track record for quality services in its other hospitals. Prime has made several representations about patient care and health services. Specifically, it

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The Court did not require this, but Prime volunteered at the hearing to include a $10 Million Dollar guarantee.

[70] *See* R.I. Gen. Laws § 23-17.14-8 (b)(1).

represents that its hospitals are currently JCAHO accredited and in good standing. *See* Initial Application Response to Question 64. The Joint Commission of National Quality Approval released a report in 2011 and 2012 that recognized top performers on key measures. Prime represents that several of its hospitals were recognized. *See* Prime Healthcare Services Presentation to the Health Services Council dated, July 9, 2013. Further Prime represents that it "has been recognized by Thomas Reuters as a Top 15 Health System in the United States based on quality measures." *See* Initial Application, Answer to Question 1.

The other relevant component to competence in this context is the ability to manage the business side of a hospital. In its twelve (12) year history, PHSI has acquired twenty-three (23) hospitals, many of which were financially-distressed. It does not appear that Prime has been denied a hospital by a regulatory agency other than a denial for the Victor Valley Hospital in California whereby the California Attorney General denied the transaction simply stating that it was "not in the public interest and will likely create a significant effect on the availability or accessibility of healthcare services to the affected community." *See* Response to Supplemental Question S2-14, Exhibit 14. On the other hand Prime has no concrete business plan regarding expansion as it relies upon the number of hospitals Dr. Reddy and his family are interested in buying. Transcript of Health Services Council, July 9, 2013, Testimony of Prem Reddy, at pg. 54, lines 1-3.

During interviews conducted pursuant to the Hospital Conversions Act review, the Attorney General found that Prime's management team has years of experience in operating community hospitals. Further, as outlined hereafter, the Attorney General's expert has found that the finances of Prime are in line with company acquiring distressed community hospitals which appears to be a signal of some level of success.

4. Standing in the Community

The issue of standing in the community is interrelated with overlapping inquiries to the question of character. Overall, given the totality of the circumstances, the Attorney General finds that Prime's character, commitment, competence, and standing in the community meet the threshold and are satisfactory for the purposes of a Hospital Conversions Act review.

H. MISCELLANEOUS

In addition to the provisions outlined above, there are also a few additional requirements of the Hospital Conversions Act that do not fit into any of the categories outlined above. They are outlined individually below.

1. Rhode Island Nonprofit Corporations Act

The Hospital Conversions Act requires that a hospital conversion comply with the Rhode Island Nonprofit Corporations Act. R.I. Gen. Laws §§ 7-6-1, *et. seq.* (the "Nonprofit Act").[71] The Nonprofit Act is comprised of 108 sections. Many of these sections discuss the governance requirements of non-profit corporations. The Attorney General makes no finding with regard to whether the Transacting Parties have complied with the Nonprofit Act and has not reviewed their corporate minute books. First, the Prime Transacting Parties: Prime Holdings, Prime Management and PHSI are neither non-profit entities nor Rhode Island corporations, therefore, the Nonprofit Act does not apply to them. Second, Rehabilitation Hospital of Rhode Island is a limited partnership not subject to the Nonprofit Act. Finally, the remaining Transacting Parties, Landmark Medical Center and Landmark Health System both have been subject to Special Mastership for over five years. These corporations have been operating without a board since that time. Accordingly, it would not be a useful exercise to determine if the Nonprofit Act has

[71] *See* R.I. Gen Laws § 23-17.14-7 (c)(19).

been complied with as it is uncertain as to the application of most of the provisions of the law given the instant circumstances.

2. Right of First Refusal

The Hospital Conversions Act requires review of whether the Proposed Transaction involves a right of first refusal to repurchase the assets. *See* R.I. Gen Laws § 23-17.14-7 (c)(27). The Asset Purchase Agreement contains no right of first refusal. The only known right of first refusal concerning the Proposed Transaction involves a certain tract of land originally conveyed by the Special Master with permission of the Court. *See* Landmark Special Mastership Order dated, April 7, 2011. The status of this right of first refusal is unknown.

3. Control Premium

With regard to the one remaining review provision of the Hospital Conversions Act, there is no control premium included in the Proposed Transaction. R.I. Gen. Laws § 23-17.14-7(c)(29).

4. Additional Issues

There are four issues that the Attorney General will address in addition to the enumerated review criteria that have come to light during the review process.

a. Prime's Ability to Fund Transaction

The Attorney General's expert, HS&S has reviewed the financial information provided by Prime and has concluded as follows:

> **Does Prime have the Resources to Finance this Transaction as Well as Ongoing Commitments to LHS?**
>
> Based on Prime's Income Statement (Consolidated) for the six months ended 6/30/13, Prime generated $65.8 million in income from operations. This represents an operating margin of 6.6% of revenue. Prime's operating margins

were in excess of 8% for each year from 2010 to 2012. This is in the upper quartile for US hospitals[72].

Prime's Balance Sheet as of 6/30/13 indicates that Prime had $86.2 million in cash and cash equivalents and $604.6 million in current assets. The $86.2 million represents approximately 35.1 days cash on hand, which is low as compared to the 2011 median of 85.8 days for US hospitals[1][sic.]. Prime's total assets as of 6/30/2013 were $1,311.1 million. Prime's total liabilities were $1,007.2 million, which includes $323.2 million in current liabilities and $684.1 million in non-current liabilities. Shareholders' equity for Prime was $303.9 million as of 6/30/2013. Given these statistics, Prime has a relatively poor liquidity position and a relatively high level of debt as compared to equity. Supporting documentation is provided at the end of this document.

Based on the terms outlined above, approximately $11.5 million will be required to close the LHS acquisition. An additional $6 million (based on one-fifth of the $30 million commitment over five years) will be required in the first year to meet the capital commitment as outlined in the Asset Purchase Agreement. Prime has already provided the deposit of $1 million and will forgive $1 million that is due to Buyer, according to the Working Capital Loan Agreement.

On September 16, 2013, Healthcare Finance Group, LLC (HFG) announced a five-year, $475 million financing transaction for Prime. This is comprised of a $225 million "asset-based facility" loan and a $250 million "senior secured term loan." Including this financing, Prime will have access to a total of $550 million for acquisitions and additional financing will be available in the future.[73] Even without the incremental HFG financing, despite its relatively poor liquidity position, Prime has sufficient cash and current assets to close this transaction.

During on-site meetings with representatives from the Rhode Island Office of the Attorney General and the Rhode Island Department of Health, several members of Prime's senior leadership team each stated that Prime has more than sufficient financial resources to fund the closing of this transaction and also meet ongoing capital commitments.

Based on the financial documentation submitted by Prime and the representations of Prime's leaders, the organization has the resources to finance this transaction as well as ongoing capital commitments. Prime's capacity to meet future capital commitments could be compromised if the organization enters into other transactions that (in total) exceed its available financial resources and access to capital, or if its financial performance/position deteriorates.

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[72] Source: Ingenix Almanac of Hospital Financial and Operating Indicators, 2013.
[73] *See* Response to Supplemental Questions S2-28.

Given the opinion of HS&S, absent any exigent circumstances or, as aptly pointed out by HS&S, any acquisition plan or other commitments that would over-extend Prime, it currently appears to have the financial ability to fund the Proposed Transaction.

b. Mandatory Conditions

Among the changes to the Hospital Conversions Act in 2012 was the imposition of mandatory conditions on for-profit acquirors. *See* R.I. Gen. Laws § 23-17.14-28. The Legislature crafted eight (8) such conditions for DOH with a wide variety of topics. *See* R.I. Gen. Laws § 23-17.14-28(b). As for the Attorney General, one such condition was imposed, namely: "the acquiror's adherence to a minimum investment to protect the assets, financial health, and well-being of the new hospital and for community benefit." *See* R.I. Gen. Laws § 23-17.14-28(c). With regard to these pre-determined conditions, if either Department deems them "not appropriate or desirable in a particular conversion," such Department must include rationale for not including the condition. *See* R.I. Gen. Laws § 23-17.14-28(b) and (c). The Attorney General finds the condition contained in R.I. Gen. Laws § 23-17.14-28(c) to be ambiguous and the Attorney General is unable to determine its intent. Notwithstanding, the Attorney General finds that to the extent that such condition is applicable, the Transacting Parties have satisfied it by the obligations contained in the Asset Purchase Agreement and no additional condition will be added other than those already imposed.

c. Use of Monitor

Another change to the Hospital Conversions Act in 2012 was to include a requirement that a for-profit acquiror file reports for a three (3) year period. *See* R.I. Gen. Laws § 23-17.14-28(d)(1). In addition, such section requires that the Attorney General and DOH "monitor, assess and evaluate the acquiror's compliance with all of the conditions of approval." *See* R.I. Gen.

Laws § 23-17.14-28(d)(2). Further, there shall be an annual review of "the impact of the conversion on health care costs and services within the communities served." *Id.* The costs of these reviews will be paid by the acquiror and placed into escrow during the monitoring period. *See* R.I. Gen. Laws § 23-17.14-28(d)(3). No Initial Application can be approved until an agreement has been executed with the Attorney General and the Director of the DOH for the payment of reasonable costs for such review. *Id.* The Transacting Parties have executed a Reimbursement Agreement dated, October 28, 2013. The Attorney General's conditions will be monitored by an individual or entity chosen by the Attorney General and paid for by Prime. An agreement with such monitor and Prime will be drafted and executed prior to the Closing on the Proposed Transaction.

d. Health Planning

As during the previous Landmark review, there has been some discussion in the health care community about the role of Landmark in the Rhode Island health care system. The Attorney General notes that the Hospital Conversions Act in its present form is not a health planning tool. Although there has been much talk about creating a so-called state health plan, that goal has not been reached, nor does it appear likely to be reached in the immediate future. Therefore, it is not the position of the Attorney General to use the Hospital Conversion Act to effectuate health planning that should be properly done elsewhere with input from a variety of groups. The Hospital Conversion Act contains a set of criteria, it does not allow for the Attorney General to opt for a different model or to suggest a different suitor for Landmark. Clearly, a five year special mastership for a hospital is not an ideal situation and is not the model which others should endeavor to match. However, the question to be answered by this review is whether this particular transaction meets the criteria of the Hospital Conversions Act.

V. CONCLUSION

Now we find Landmark Medical Center and the Rehabilitation Hospital of Rhode Island, yet again at the crossroads of regulatory approval and the possibility that this transaction will proceed to a successful closing. Unfortunately, this is a position they have been in before. As in its previous review, this Department has diligently reviewed the Proposed Transaction pursuant to the Hospital Conversions Act. This Department continues to spend significant time conducting reviews of hospital transactions, with this being the third approval of a hospital conversion issued by this Department in this calendar year, not to mention the review and approval of the prior Landmark deal. During the public meeting there was much discussion about closure of Landmark. However, as has been the position of the Attorney General for the past several years, the Attorney General has no intention to sit idly by and watch a closure of Landmark happen. However, this does not mean that the Attorney General can simply rubber-stamp a deal that is handed to it even in a precarious situation.

While the Act is no guarantee that a hospital will not be sold to an entity with a different plan in mind than what the surrounding community may value, the Act at the very least provides a minimum framework for review of a hospital transaction. The Attorney General hopes that Prime becomes everything it has promised to be for the people of Northern Rhode Island. As with all of the Attorney General's reviews pursuant to the Hospital Conversions Act, this Decision represents this Department's best efforts and a careful review of the Proposed Transaction given the information available.

Wherefore, based upon the information provided above in this Decision, the Proposed Transaction is **APPROVED WITH CONDITIONS.** These conditions are outlined below.

VI. CONDITIONS

1. Upon their appointment and for the next three (3) years, please provide the names, addresses and affiliations of all members appointed to any board of Prime Healthcare Services-Landmark LLC.

2. The Board of Directors of Prime Healthcare Services-Landmark LLC shall consist of no less than eleven (11) members of which shall include at least twenty-five percent (25%) community directors[74] all of which shall: (i) be independent of and not employed by or affiliated with Prime or its affiliates; and (ii) not be an elected official or an individual that is subject to the Rhode Island Code of Ethics or employed by any federal, state or local government.

3. For a period of five (5) years, Prime Healthcare Services-Landmark LLC shall provide corporate documents requested by the Department of Attorney General to evidence compliance regarding board composition as required by this Decision. In addition, Prime Healthcare Services-Landmark LLC shall provide any proposed amendments to their corporate documents 30 days prior to amendment.

4. For the next three (3) years, identify any contracts between any of the Transacting Parties and any of the current officers, directors, board members or senior management other than employment agreements including the Special Master, his law firm or its affiliates.

5. That a binding agreement acceptable to the Department of Attorney General with the Rhode Island Foundation or other appropriate entity for disbursement of all charitable assets be provided.

6. A cy pres petition be filed and granted prior to closing of the Proposed Transaction allowing all charitable assets to be transferred to the Rhode Island Foundation or other appropriate entity for disbursement in accordance with donor intent.

7. For the term of five (5) years, all assets transferred by the Asset Purchase Agreement shall be utilized for the benefit of Landmark only and shall not be utilized for projects or programs situated outside the State of Rhode Island without the consent of the Department of Attorney General.

8. That the Proposed Transaction be implemented as outlined in the Initial Application.

9. That the Transacting Parties comply with applicable state tax laws.

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[74] A community director shall be defined as an individual that resides or works within the Landmark Medical Center Service Area and has the appropriate skill sets to serve on a hospital's board of directors. The "Landmark Medical Center Service Area" is comprised of the following towns in Rhode Island: Woonsocket; North Smithfield; Cumberland; Lincoln; Burrillville; and Glocester and the following towns in Massachusetts: Blackstone, Bellingham and Millville. *See* Initial Application, Exhibit 53(d)(i).

10. All Landmark entities identified subject to Special Mastership shall be wound down and all necessary documents must be filed with applicable state agencies, including, but not limited to the Secretary of State and the Division of Taxation.

11. That all costs and expenses due from the Transacting Parties pursuant to the Reimbursement Agreement dated, March 12, 2013, be paid in full prior to closing of the Proposed Transaction.

12. That PHSI guarantee the full amount of financial obligations contained in the Asset Purchase Agreement or other assurances satisfactory to the Attorney General.

13. That Prime provides information requested by the Department of Attorney General to determine its compliance with the Asset Purchase Agreement and the Conditions of this Decision.

14. That Prime complies with the Reimbursement Agreement dated, October 26, 2013, for retention by the Attorney General of an expert to assist the Attorney General with enforcing compliance with these Conditions. Further, Prime shall enter into an additional agreement outlining the terms of its obligations regarding cooperation with the Attorney General and any expert retained to assist the Attorney General with enforcing compliance with these Conditions.

15. Prime shall provide information about any actions taken against Prime or any final resolution to the investigation currently being conducted by the Department of Justice and Office of Inspector General regarding coding at Prime's hospitals. For a term of five (5) years, Prime shall inform the Attorney General of any actions initiated against it or any of its hospitals or affiliates by any governmental entities. The information to be included in these reports shall be determined by the Attorney General.

16. The bylaws of Prime-Landmark shall be officially amended in conformance with the revised bylaws submitted by Prime's counsel on July 8, 2013 prior to Closing.

All of the above Conditions are directly related to the proposed conversion. The Attorney General's APPROVAL WITH CONDITIONS is contingent upon the satisfaction of the Conditions. The Proposed Transaction shall not take place until Conditions 5, 6, 11, 12 and 16 have been satisfied. The Attorney General shall enforce compliance with these Conditions pursuant to the Hospital Conversions Act including R.I. Gen. Laws § 23-17.14-30.

Peter F. Kilmartin
Attorney General
State of Rhode Island

Jodi Bourque
Assistant Attorney General

NOTICE OF APPELLATE RIGHTS

Under the Hospital Conversions Act, this decision constitutes a final order of the Department of Attorney General. Pursuant to R.I. Gen. Laws § 23-17.14-34, any transacting party aggrieved by a final order of the Attorney General under this chapter may seek judicial review by original action filed in the Superior Court.

CERTIFICATION

I hereby certify that on this 28th day of October, 2013, a true copy of this Decision was sent via electronic and first class mail to counsel for the Transacting Parties:

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